



KEN SALAZAR
Attorney General

DONALD S. QUICK
Chief Deputy Attorney General

ALAN J. GILBERT
Solicitor General

STATE OF COLORADO
DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

STATE SERVICES BUILDING
1525 Sherman Street - 5th Floor
Denver, Colorado 80203
Phone (303) 866-4500
FAX (303) 866-5691

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Advisory Opinion

Multiple Instruments on Deferred Deposit Loans and Notice of Payment in Full
and Release of Security

This office has noted compliance issues during recent examinations of deferred deposit lenders. This advisory opinion discusses these issues and sets forth our current enforcement policies.

Some deferred deposit lenders hold a post-dated check from consumers and also obtain the consumer's signed, written authorization to automatically debit the consumer's bank account through the automated clearing house (ACH) system or similar means of payment not involving deposit of the consumer's personal check. This practice does not comply with the Deferred Deposit Loan Act (DDLA).¹ This advisory opinion also addresses UCCC section 5-3-104 on evidence of payment in full and release of security interests.

Multiple Instruments

DDLA sections 5-3.1-102(3) & (4) state:

(3) "Deferred deposit loan" means a consumer loan whereby the lender, for a fee, finance charge, or other consideration, does the following:

(a) Accepts *a dated instrument* from the consumer as *sole security* for the loan and no other collateral;

(b) Agrees to hold *the instrument* for a period of time prior to negotiation or deposit of *the instrument*; and

(c) Pays to the consumer, credits to the consumer's account, or pays to another person on the consumer's behalf the amount of *the instrument*, less finance charges permitted by section 5-3.1-105.

(4) "Instrument" means *a personal check or authorization to transfer or withdraw funds* from an account signed by the consumer and made payable to a person subject to this article.

(emphasis added)

These definitions indicate that only one instrument may be held on a deferred deposit loan. The statute uses the phrases "a dated instrument", "agrees to hold the instrument", and "a personal

¹ The DDLA is an article of the Uniform Consumer Credit Code (UCCC) and most of the UCCC's provisions apply to deferred deposit loans. UCCC section 5-3.1-119.

check or authorization.” There is no legal authority for a deferred deposit lender to hold two instruments such as the consumer’s personal check (usually post-dated) and an ACH or other payment authorization. Obtaining two instruments increases the possibility that both instruments may be negotiated with the result that the lender collects twice the amount due. The legislature was concerned with this potential abuse in other areas. For example, consumers have a right to redeem the instrument by paying the full loan amount prior to negotiation or presentment of the instrument. DDLA section 5-3.1-111. The law could have allowed the lender to retain the instrument but void it in this situation, but instead redemption is required. Redemption typically means to recover possession of property.

In addition, as of July 1, 2004, section 5-3.1-102(3)(a), printed above, states that the instrument is the sole security for the loan and that no other collateral may be taken. If the lender holds two instruments, it has improperly obtained additional security for the loan.

For these reasons, pursuant to section 5-3.1-102, only a single instrument may be used for a deferred deposit loan. Deferred deposit lenders holding two instruments for the same loan are not in compliance with the law and must cease this practice.

Evidence of Payment and Release of Security Interest

UCCC section 5-3-104(3) states:

Within thirty days after a consumer has fulfilled all obligations with respect to a consumer credit transaction, other than one pursuant to a revolving credit account, the creditor shall deliver or mail to the consumer written evidence acknowledging payment in full of all obligations with respect to the transaction and written evidence of release of any security interest and termination of any financing statement held, retained, or acquired.

The law clearly states that a lender must deliver or mail to the consumer written evidence acknowledging payment in full and release of any security interest within 30 days of payment in full. Obviously, the lender may send a written letter or notice to the consumer and satisfy this section. However, some deferred deposit lenders are reluctant to do this due to the short term of payday loans and the volume of loans made. Instead, they negotiate the consumer’s check and attempt to provide evidence of payment in full by the return of the check through the banking system, the consumer’s option to obtain a copy of the negotiated check from his or her bank, or through the consumer’s bank account statement. The lender does not provide any additional notice of payment in full and release of security. In compliance examinations, we have generally not taken exception to this practice although it does not meet the statutory requirement that the lender, not a third party, provide the required written notices. We will expand our current enforcement policy to the lender’s negotiation of an ACH or other authorization provided the consumer receives timely written notification from the lender, the consumer’s bank, or similar third-party that the ACH or debit authorization transaction has been successful and paid in full. However, we advise lenders that upon receipt of a consumer request, they should provide separate written notice of payment in full and/or release of the security interest.

This enforcement policy is due in part to limited resources and the need to prioritize compliance and enforcement actions. Nonetheless, deferred deposit lenders must be aware that the enforcement policy stated in this advisory opinion may not protect them from civil liability in private legal actions. The section of this opinion on evidence of payment and release of security is not subject to section 5-6-104(4), C.R.S.

Summary

Deferred deposit lenders may hold as an instrument the consumer's signed paper check or written authorization to debit the consumer's account, but not both. Our current enforcement policy for compliance examinations of licensed deferred deposit lenders is that no exception will be noted if: (1) the lender negotiates the consumer's paper check or ACH/debit authorization, and (2) the consumer's bank or similar entity provides timely written evidence to the consumer that the check or debit authorization has been successful.

The provisions of this advisory opinion on multiple instruments take effect on December 7, 2004.²

/s/ Laura E. Udis
LAURA E. UDIS
Administrator
Uniform Consumer Credit Code
(303) 866-4494
(303) 866-5691 (FAX)

² The limitation of one instrument is not a new policy or procedure subject to section 5-3.1-118(3) but merely restates current statutes. Nonetheless, the Administrator will voluntarily delay this advisory opinion's effective date.